

(6) Investment activity by State-chartered credit unions, except as provided in § 741.3(a)(2) and § 741.219 of this chapter.

[68 FR 32960, June 3, 2003, as amended at 69 FR 27828, May 17, 2004]

### § 703.2 Definitions.

*The following definitions apply to this part:*

*Adjusted trading* means selling an investment to a counterparty at a price above its current fair value and simultaneously purchasing or committing to purchase from the counterparty another investment at a price above its current fair value.

*Associated personnel* means a person engaged in the investment banking or securities business who is directly or indirectly controlled by a National Association of Securities Dealers (NASD) member, whether or not this person is registered or exempt from registration with NASD. Associated personnel includes every sole proprietor, partner, officer, director, or branch manager of any NASD member.

*Banker's acceptance* means a time draft that is drawn on and accepted by a bank and that represents an irrevocable obligation of the bank.

*Bank note* means a direct, unconditional, and unsecured general obligation of a bank that ranks equally with all other senior unsecured indebtedness of the bank, except deposit liabilities and other obligations that are subject to any priorities or preferences.

*Borrowing repurchase transaction* means a transaction in which the Federal credit union agrees to sell a security to a counterparty and to repurchase the same or an identical security from that counterparty at a specified future date and at a specified price.

*Call* means an option that gives the holder the right to buy a specified quantity of a security at a specified price during a fixed time period.

*Collateralized Mortgage Obligation (CMO)* means a multi-class mortgage related security.

*Collective investment fund* means a fund maintained by a national bank under 12 CFR part 9 (Comptroller of the Currency's regulations).

*Commercial mortgage related security* means a mortgage related security, as

defined below, except that it is collateralized entirely by commercial real estate, such as a warehouse or office building, or a multi-family dwelling consisting of more than four units.

*Counterparty* means the party on the other side of the transaction.

*Custodial Agreement* means a contract in which one party agrees to hold securities in safekeeping for others.

*Delivery versus payment* means payment for an investment must occur simultaneously with its delivery.

*Deposit note* means an obligation of a bank that is similar to a certificate of deposit but is rated.

*Derivatives* means any derivative instrument as defined under generally accepted accounting principles (GAAP).

*Embedded option* means a characteristic of an investment that gives the issuer or holder the right to alter the level and timing of the cash flows of the investment. Embedded options include call and put provisions and interest rate caps and floors. Since a prepayment option in a mortgage is a type of call provision, a mortgage-backed security composed of mortgages that may be prepaid is an example of an investment with an embedded option.

*Eurodollar deposit* means a U.S. dollar-denominated deposit in a foreign branch of a United States depository institution.

*European financial options contract* means an option that can be exercised only on its expiration date.

*Exchangeable Collateralized Mortgage Obligation* means a class of a collateralized mortgage obligation (CMO) that, at the time of purchase, represents beneficial ownership interests in a combination of two or more underlying classes of the same CMO structure. The holder of an exchangeable CMO may pay a fee and take delivery of the underlying classes of the CMO.

*Fair value* means the amount at which an instrument could be exchanged in a current, arms-length transaction between willing parties, as opposed to a forced or liquidation sale.

*Financial options contract* means an agreement to make or take delivery of a standardized financial instrument

upon demand by the holder of the contract as specified in the agreement.

*Immediate family member* means a spouse or other family member living in the same household.

*Industry-recognized information provider* means an organization that obtains compensation by providing information to investors and receives no compensation for the purchase or sale of investments.

*Investment* means any security, obligation, account, deposit, or other item authorized for purchase by a Federal credit union under Sections 107(7), 107(8), or 107(15) of the Act, or this part, other than loans to members.

*Investment repurchase transaction* means a transaction in which an investor agrees to purchase a security from a counterparty and to resell the same or an identical security to that counterparty at a specified future date and at a specified price.

*Maturity* means the date the last principal amount of a security is scheduled to come due and does not mean the call date or the weighted average life of a security.

*Mortgage related security* means a security as defined in Section 3(a)(41) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(41)), *e.g.*, a privately-issued security backed by first lien mortgages secured by real estate upon which is located a dwelling, mixed residential and commercial structure, residential manufactured home, or commercial structure, that is rated in one of the two highest rating categories by at least one nationally-recognized statistical rating organization.

*Mortgage servicing rights* means a contractual obligation to perform mortgage servicing and the right to receive compensation for performing those services. Mortgage servicing is the administration of a mortgage loan, including collecting monthly payments and fees, providing recordkeeping and escrow functions, and, if necessary curing defaults and foreclosing.

*Negotiable instrument* means an instrument that may be freely transferred from the purchaser to another person or entity by delivery, or endorsement and delivery, with full legal title becoming vested in the transferee.

*Net worth* means the retained earnings balance of the credit union at quarter end as determined under generally accepted accounting principles and as further defined in § 702.2(f) of this chapter.

*Official* means any member of a Federal credit union's board of directors, credit committee, supervisory committee, or investment-related committee.

*Ordinary care* means the degree of care, which an ordinarily prudent and competent person engaged in the same line of business or endeavor should exercise under similar circumstances.

*Pair-off transaction* means an investment purchase transaction that is closed or sold on, or before the settlement date. In a pair-off, an investor commits to purchase an investment, but then pairs-off the purchase with a sale of the same investment before or on the settlement date.

*Put* means an option that gives the holder the right to sell a specified quantity of a security at a specified price during a fixed time period.

*Registered investment company* means an investment company that is registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a). Examples of registered investment companies are mutual funds and unit investment trusts.

*Regular way settlement* means delivery of a security from a seller to a buyer within the time frame that the securities industry has established for immediate delivery of that type of security. For example, regular way settlement of a Treasury security includes settlement on the trade date (cash), the business day following the trade date (regular way), and the second business day following the trade date (skip day).

*Residual interest* means the remainder cash flows from collateralized mortgage obligations/real estate mortgage investment conduits (CMOs/REMICs), or other mortgage-backed security transaction, after payments due bondholders and trust administrative expenses have been satisfied.

*Securities lending* means lending a security to a counterparty, either directly or through an agent, and accepting collateral in return.

## National Credit Union Administration

## § 703.3

*Security* means a share, participation, or other interest in property or in an enterprise of the issuer or an obligation of the issuer that:

(1) Either is represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer;

(2) Is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment; and

(3) Either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

*Senior management employee* means a Federal credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), an assistant chief executive officer, and the chief financial officer.

*Small business related security* means a security as defined in Section 3(a)(53) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(53), e.g., a security that is rated in 1 of the 4 highest rating categories by at least one nationally recognized statistical rating organization, and represents an interest in one or more promissory notes or leases of personal property evidencing the obligation of a small business concern and originated by an insured depository institution, insured credit union, insurance company, or similar institution which is supervised and examined by a Federal or State authority, or a finance company or leasing company. This definition does not include Small Business Administration securities permissible under §107(7) of the Act.

*Weighted average life* means the weighted-average time to the return of a dollar of principal, calculated by multiplying each portion of principal received by the time at which it is expected to be received (based on a reasonable and supportable estimate of that time) and then summing and dividing by the total amount of principal.

*When-issued trading of securities* means the buying and selling of securities in the period between the an-

nouncement of an offering and the issuance and payment date of the securities.

*Yankee dollar deposit* means a deposit in a United States branch of a foreign bank licensed to do business in the State in which it is located, or a deposit in a State-chartered, foreign controlled bank.

*Zero coupon investment* means an investment that makes no periodic interest payments but instead is sold at a discount from its face value. The holder of a zero coupon investment realizes the rate of return through the gradual appreciation of the investment, which is redeemed at face value on a specified maturity date.

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### § 703.3 Investment policies.

A Federal credit union's board of directors must establish written investment policies consistent with the Act, this part, and other applicable laws and regulations and must review the policy at least annually. These policies may be part of a broader, asset-liability management policy. Written investment policies must address the following:

(a) The purposes and objectives of the Federal credit union's investment activities;

(b) The characteristics of the investments the Federal credit union may make including the issuer, maturity, index, cap, floor, coupon rate, coupon formula, call provision, average life, and interest rate risk;

(c) How the Federal credit union will manage interest rate risk;

(d) How the Federal credit union will manage liquidity risk;

(e) How the Federal credit union will manage credit risk including specifically listing institutions, issuers, and counterparties that may be used, or criteria for their selection, and limits on the amounts that may be invested with each;

(f) How the Federal credit union will manage concentration risk, which can result from dealing with a single or related issuers, lack of geographic distribution, holding obligations with similar characteristics like maturities and indexes, holding bonds having the